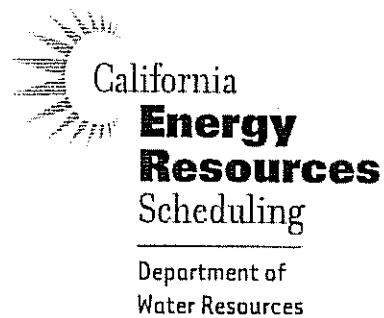


Department of Water Resources Electric Power Fund Financial Statements

March 31, 2004



Department of Water Resources Electric Power Fund

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Department of Water Resources Electric Power Fund

Management's Discussion and Analysis

USING THIS REPORT

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in financial position of the Department of Water Resources Electric Power Fund (Fund), which is administered by the California Department of Water Resources (DWR). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follows *Management's Discussion and Analysis*.

The basic financial statements include three required statements, which provide different views of the Fund. They are: the statement of net assets, the statement of activities and the statement of cash flows. These statements provide current and long-term information about the Fund and its activities. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. The statement of net assets includes all assets and liabilities as of a specified date. The statement of activities presents all of the revenues and expenses for a specified time period. The final required statement is the statement of cash flows. This statement reports cash receipts, disbursements and the net change in cash resulting from three principal types of activities; operating activities, financing activities and investing activities. In order for the basic financial statements to be complete, they must be accompanied by a complete set of footnotes. The notes to the financial statements provide disclosures which are required to conform to generally accepted accounting principles. The Fund has adopted accounting standards promulgated by the Governmental Accounting Standards Board.

This report should be read in conjunction with the Fund's June 30, 2003 audited financial statements.

HISTORY AND FINANCING

The Fund was established in January 2001, in connection with the Governor of California's emergency proclamation and subsequent legislation to assist in mitigating the effects of a statewide energy supply emergency.

In November 2002, DWR completed the issuance of \$11.3 billion in revenue bonds. The proceeds of the bond issues, along with \$2.1 billion of cash and investments in the Fund, were used to repay the outstanding balance of a \$4.3 billion term loan from a financial consortium led by JPMorgan Chase Bank, repay \$6.2 billion in advances from the State's General Fund with interest, and establish separate accounts in the Fund as required by the Bond Indenture. The bonds are payable from Bond Charges and, if necessary, other revenues, collected over a 20-year period.

DWR also entered into \$1.4 billion notional amount of interest rate swaps, reducing its unhedged variable rate debt to approximately 25% of the initial par value of the bonds issued.

IMPLEMENTATION OF REVENUE REQUIREMENTS SINCE JUNE 30, 2003

DWR's responsibility for purchasing the "residual net short", as defined in the Bond Indenture, was transferred to the investor owned utilities on January 1, 2003. DWR was then permitted, under the terms of the Bond Indenture, to reduce the required level of funding of the Operating Account and the Operating Reserve Account.

Based on the net impact of 1) the ability to reduce minimum account balances and reserves, 2) the expected receipt of cash for past due amounts being held in trust by Pacific Gas & Electric Company (PG&E), and 3) increases in actual and forecasted costs, DWR developed its 2003 Supplemental Revenue

Department of Water Resources Electric Power Fund

Management's Discussion and Analysis

Requirement, reducing DWR's 2003 revenue requirement needs by \$1.002 billion. The 2003 Supplement Revenue Requirement was submitted to the CPUC on July 1, 2003.

On September 4, 2003, the CPUC implemented the 2003 Supplemental Revenue Requirement and DWR transferred \$147 million from the Operating Reserve Account to the Operating Account. The past due amount from PG&E (net of a \$444 million allocable bill credit for PG&E customers) was collected on September 11, 2003, and deposited in the Operating Account. The Operating Account then had sufficient funds on hand to be able to reduce its cash balance by \$558 million through bill credits for the customers of Southern California Edison Company and San Diego Gas & Electric Company and still remain in compliance with the minimum cash balance requirements of the Bond Indenture. Processing of substantially all of the bill credits was finalized during the quarter ended December 31, 2003.

DWR's 2004 Revenue Requirement was submitted to the CPUC on September 18, 2003. On January 8, 2004, the CPUC implemented the 2004 Revenue Requirement on an interim basis and DWR transferred \$51 million from the Operating Reserve Account to the Operating Account. The 2004 costs are higher than in 2003 due in part to the Department's expectation of supplying 49 million megawatt hours for customers compared to 42.5 million megawatt hours in 2003. The increase in volume is due in part to increased power supply being available from new power plants that have been built as a result of DWR's long-term contracts.

STATEMENT OF NET ASSETS

The Fund's assets and liabilities as of March 31, 2004 and June 30, 2003 are summarized as follows (in millions):

	March 31, 2004	June 30, 2003
Restricted cash and investments		
Operating Account	\$ 1,129	\$ 1,177
Priority Contract Account	76	84
Bond Charge Collection Account	158	156
Bond Charge Payment Account	573	229
Other investments	39	37
Recoverable costs, current portion	529	1,129
Other current assets	12	36
Long-term restricted cash and investments	1,506	1,704
Recoverable costs, net of current portion	8,122	7,568
Total assets	<u>\$ 12,144</u>	<u>\$ 12,120</u>
Long-term debt, including current portion	\$ 11,604	\$ 11,636
Other current liabilities	540	484
Total capital and liabilities	<u>\$ 12,144</u>	<u>\$ 12,120</u>

Department of Water Resources Electric Power Fund

Management's Discussion and Analysis

Restricted Cash and Investments

As required by the Bond Indenture, there are six separate restricted cash and investments accounts. Four of the accounts are classified as current assets, while the Operating Reserve Account and Debt Service Reserve Account are classified as long-term assets. From the dates of issuance of the revenue bonds through March 31, 2004, the daily balance in each of the restricted cash and investments accounts met or exceeded balances required by the Bond Indenture.

The Operating Account had a net decrease of \$48 million in the nine months ended March 31, 2004. This reflects the net impact of the \$1 billion bill credit, collection of past due amounts from PG&E, transfers totaling \$198 million from the Operating Reserve Account, and higher than expected remittances by one of the IOUs.

The \$275 million increase in the Bond Charge Payment Account was anticipated for the semi-annual debt service payment, including \$180 million in principal, due on May 1, 2004.

The \$198 million decrease in the long-term restricted cash and investments reflects the reductions in the Operating Reserve Account balance as permitted by the Bond Indenture due to the end of DWR's responsibility for procurement of the "residual net short". The March 31, 2004 balance of \$579 million represents twelve percent of projected annual operating expenses of the Fund for calendar year 2004 as determined in the 2004 Revenue Requirement.

Recoverable Costs

The current portion of recoverable costs reflects billings to IOU customers that have not yet been collected. The current portion of recoverable costs decreased \$600 million from June 30, 2003 to March 31, 2004, primarily due to the collection of \$521 million of past due amounts owed by PG&E, and higher than expected remittances by one of the IOUs.

Long-term recoverable costs consist of costs that are recoverable through future billings. The \$752 million increase is primarily attributable to the aforementioned bill credit.

Revenue Bonds

The amount of revenue bonds outstanding at March 31, 2004 and June 30, 2003 reflect the par value of the bonds issued plus unamortized premium. The first principal payment of \$180 million on the revenue bonds is scheduled for May 1, 2004.

Accrued Interest Payable

Accrued interest payable is \$172 million at March 31, 2004 as compared to \$69 million at June 30, 2003. The \$103 million increase as of March 31, 2004 is anticipated as interest payments on the fixed rate bonds are made semi-annually on May 1st and November 1st, while the variable rate bonds provide for more frequent payments.

Department of Water Resources Electric Power Fund

Management's Discussion and Analysis

STATEMENT OF ACTIVITIES

The Fund's activities for the three and nine months ended March 31, 2004 and 2003 are summarized as follows (in millions):

	3 months ended March 31		9 months ended March 31	
	2004	2003	2004	2003
Revenues				
Power charges	\$ 1,343	\$ 1,058	\$ 3,059	\$ 3,598
Bond charges	189	155	655	207
Interest	59	16	87	46
Total revenues	<u>1,591</u>	<u>1,229</u>	<u>3,801</u>	<u>3,851</u>
Expenses:				
Power purchases	1,239	960	3,982	3,488
Interest expense	117	101	327	345
Other	20	15	46	290
Recovery (deferral) of recoverable costs	<u>215</u>	<u>153</u>	<u>(554)</u>	<u>(272)</u>
Total expenses	<u>1,591</u>	<u>1,229</u>	<u>3,801</u>	<u>3,851</u>
Net income	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Power Charges

Power Charges increased by \$285 million (27%) in the three months ended March 31, 2004 as compared to the comparable three months ended March 31, 2003. This is attributable to the increased amount of power purchased as described in the Power Purchases section below.

Power Charges decreased by \$539 million in the nine months ended March 31, 2004 as compared to the comparable period in 2003. This decrease is primarily attributable to recognition of the \$1.002 billion bill credit to ratepayers as a reduction of Power Charges. The impact of the bill credit is partially offset by \$463 million in increased energy sales to IOU customers, as described in the Power Purchases section below.

Bond Charges

Bond Charges earned for the three and nine months ended March 31, 2004 and 2003, are comparable to those forecast in the cash flow analyses utilized in developing the revenue bond structure. Since the Bond Charge was not implemented until November 2002, Bond Charge revenue for the nine months ended March 31, 2003 is substantially lower than for the comparable period in 2004.

Interest Income

Interest income for the three months and nine months ended March 31, 2004 is higher by \$43 million and \$41 million, respectively, than for the comparable periods in 2003. The higher amounts are due

Department of Water Resources Electric Power Fund Management's Discussion and Analysis

principally to the receipt of \$38 million from PG&E for interest on past due remittances. Both the interest income and past due remittances have been received in full.

Power Purchases

DWR power costs for the three months and nine months ended March 31, 2004 were \$279 million and \$494 million higher, respectively, than in the comparable periods ended March 31, 2003. For the three months ended March 31, 2004, this represented a 29% increase over the three months ended March 31, 2003. The major portion of the increase is attributable to more power being provided under some long-term contracts and from new generation facilities that became operational in summer 2003. Changed market conditions also led to increased utilization of DWR contracts.

Administrative Expenses

Administrative expenses incurred during the three months ended March 31, 2004, are \$5 million higher than for the three months ended March 31, 2003 due primarily to the assessment of statewide "pro rata" costs by the State Department of Finance for centralized services provided to the Fund by other state departments.

Administrative expenses incurred during the nine months ended March 31, 2004 are \$244 million less than incurred during the nine months ended March 31, 2003. Bond issuance costs in Fall 2002 accounted for almost all of the difference between the two periods.

Interest Expense

Interest expense incurred during the three months ended March 31, 2004, is \$16 million higher than was incurred during the respective three months ended March 31, 2003. The increase is primarily attributable to fixed rate interest rate swaps, which were in place for the entire three month period in 2004, but for only a portion of the three months ended March 31, 2003. The increase also reflects the change in percentage of LIBOR received by the Fund under certain of the interest rate swaps from 80% of LIBOR to 67% of LIBOR as of January 1, 2004.

Interest expense for the nine months ended March 31, 2004 is \$18 million less than was incurred for the nine months ended March 31, 2003. The increase in interest expense for the three months ended March 31, 2004 is more than offset by the effective interest rate for the revenue bonds (4.8%) being less than the interest rates for both the General Fund advances and the term loan which were outstanding through Fall 2002 and had rates of 5.3% and 5.7%, respectively.

Department of Water Resources Electric Power Fund Management's Discussion and Analysis

FUTURE OPERATIONS

DWR will administer the Fund until such time as the revenue bonds are completely retired. Revenue requirements for the repayment of the bonds will be determined at least annually and submitted to the CPUC. Under the terms of the Rate Agreement between the CPUC and DWR, the CPUC is required to implement Bond Charges for the customers of the IOUs and Energy Service Providers such that the Fund will always have monies to pay bond related costs, including debt service and swap payments, when due.

DWR has financial and legal responsibility for the power supply contracts, including the purchase of natural gas for some of the contracts, for the life of the contracts. DWR cannot enter into any new power supply contracts and the last of the power supply contracts expires in 2013. Revenue requirements for the payment of energy purchased under the power supply contracts will be determined at least annually and submitted to the CPUC. Under the terms of the Rate Agreement between the CPUC and DWR, the CPUC is required to implement Power Charges such that the Fund will receive necessary monies to meet its revenue requirements.

Ultimately the financial responsibility for the power supply contracts may be transferred to the IOUs as part of complete assignment of the contracts and release of DWR. However, there are a number of issues to be addressed, including IOU creditworthiness and counterparty approval, before the contracts can be assigned.

Department of Water Resources Electric Power Fund
Statements of Net Assets
March 31, 2004 and June 30, 2003 (in millions)

	March 31, 2004	June 30, 2003
Assets		
Current assets:		
Cash and investments		
Restricted cash and investments:		
Operating Account	\$ 1,129	\$ 1,177
Priority Contract Account	76	84
Bond Charge Collection Account	158	156
Bond Charge Payment Account	573	229
Other investments	39	37
Recoverable costs, current portion	529	1,129
Interest receivable	12	15
Due from other funds	-	21
Total current assets	<u>2,516</u>	<u>2,848</u>
Long-term assets:		
Restricted cash and investments:		
Operating Reserve Account	579	777
Debt Service Reserve Account	927	927
Recoverable costs, net of current portion	<u>8,122</u>	<u>7,568</u>
Total long-term assets	<u>9,628</u>	<u>9,272</u>
Total assets	<u>\$ 12,144</u>	<u>\$ 12,120</u>
Capitalization and Liabilities		
Capitalization:		
Long-term debt:		
Revenue bonds	\$ 11,382	\$ 11,414
Total capitalization	<u>11,382</u>	<u>11,414</u>
Current liabilities:		
Current portion of long-term debt	222	222
Accounts payable	368	415
Accrued interest payable	<u>172</u>	<u>69</u>
Total current liabilities	<u>762</u>	<u>706</u>
Commitments and Contingencies (Note 5)		
Total capitalization and liabilities	<u>\$ 12,144</u>	<u>\$ 12,120</u>

The accompanying notes are an integral part of these financial statements.

Department of Water Resources Electric Power Fund

Statements of Activities

For the three and nine months ended March 31, 2004 and 2003

(in millions)

	For 3 months ended March 31		For 9 months ended March 31	
	2004	2003	2004	2003
Operating revenues:				
Power charges (net of bill credit of \$1,002 million in quarter ended September 30, 2003)	\$ 1,343	\$ 1,058	\$ 3,059	\$ 3,598
Total operating revenues	<u>1,343</u>	<u>1,058</u>	<u>3,059</u>	<u>3,598</u>
Operating expenses:				
Power purchases	1,239	960	3,982	3,488
Administrative expenses	20	15	46	290
Recovery (deferral) of recoverable operating costs	84	83	(969)	(180)
Total operating expenses	<u>1,343</u>	<u>1,058</u>	<u>3,059</u>	<u>3,598</u>
Income from operations	-	-	-	-
Bond charges	189	155	655	207
Interest income	59	16	87	46
Interest expense	(117)	(101)	(327)	(345)
Deferral (recovery) of recoverable debt service and related costs	<u>(131)</u>	<u>(70)</u>	<u>(415)</u>	<u>92</u>
Net income	-	-	-	-
Net assets, beginning of period	-	-	-	-
Net assets, end of period	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The accompanying notes are an integral part of these financial statements.

Department of Water Resources Electric Power Fund

Statements of Cash Flows

For the nine months ended March 31, 2004 and 2003

(in millions)

	2004	2003
Cash flows from operating income:		
Receipts from customers:		
Power charges	\$ 3,654	\$ 3,777
Payments for power purchases and other costs	(3,826)	(3,575)
Net cash provided by (used in) operating activities	(172)	202
Cash flows from non-capital financing activities:		
Proceeds from revenue bonds, net of underwriters' fees and bond insurance premiums	-	11,437
Receipts from customers for bond charges	575	186
Payments on term loan	-	(3,849)
Payments to State of California General Fund	-	(6,620)
Interest payments	(330)	(198)
Net cash provided by non-capital financing activities	245	956
Cash flows from investing activities:		
Investments purchased	(20)	-
Interest received on investments	39	62
Net cash provided by investing activities	19	62
Net increase in cash and investments	92	1,220
Restricted (2004) and Unrestricted (2003) cash and investments, beginning of year	3,350	2,119
Restricted cash and investments, end of the period	\$ 3,442	\$ 3,339
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Income from operations	\$ -	\$ -
Changes in net assets and liabilities to reconcile operating income to net cash used in operations:		
Recoverable costs	(146)	279
Due from other funds	21	1
Accounts payable	(47)	(78)
Total adjustments	(172)	202
Net cash provided by (used in) operating activities	\$ (172)	\$ 202

The accompanying notes are an integral part of these financial statements.

Department of Water Resources Electric Power Fund
Notes to Financial Statements
For the nine months ended March 31, 2004 and 2003

1. Reporting Entity

Background

In January 2001, the Governor of California issued an emergency proclamation directing the Department of Water Resources (DWR) to enter into contracts and arrangements for the purchase and sale of electric power to assist in mitigating the effect of a statewide energy supply emergency.

The Department of Water Resources Electric Power Fund (a component unit of the State of California) (Fund) was established on January 19, 2001, by Senate Bill 7 from the First Extraordinary Session of 2001 (SB7X). Assembly Bill 1 from the First Extraordinary Session of 2001 (AB1X), enacted on February 1, 2001, added Division 27 to the California Water Code to clarify and expand the powers of DWR to incur debt for the purposes of the Fund and to use amounts in the Fund for the purchase of power. The Fund is administered by DWR. Division 27 of the California Water Code (as subsequently amended by Senate Bill 31 from the First Extraordinary Session of 2001) includes the following powers and requirements:

- Authorizes DWR to act on behalf of the State of California to secure necessary power supplies for resale to customers of Pacific Gas & Electric Company (PG&E), Southern California Edison Company (SCE), and San Diego Gas & Electric Company (SDG&E) (collectively referred to as the investor owned utilities or IOUs).
- Prohibits DWR from entering into new power purchase agreements after December 31, 2002, but allows DWR to continue to administer existing contracts and enforce revenue requirements beyond that date.
- Requires DWR to retain title to all power sold, but authorizes DWR to enter into service agreements with the IOUs for transmission, distribution, billing and collection services.
- Authorizes DWR and the California Public Utilities Commission (CPUC) to enter into an agreement with respect to charges to provide for recovery by DWR of its revenue requirements.
- Authorizes DWR to issue bonds payable solely from the Fund.
- Entitles DWR to recover its revenue requirements incurred in connection with its authorized activities, including debt service, the costs of power purchases, administrative costs and reserves.

DWR began selling electricity to approximately ten million retail customers in California in January 2001. DWR purchases power from wholesale suppliers under long-term contracts and, through December 31, 2002, in short-term and spot market transactions. DWR power is delivered to the customers through the transmission and distribution systems of the IOUs and payments from the customers are collected for DWR by the IOUs pursuant to servicing arrangements approved and/or ordered by the CPUC. DWR initially financed its power purchases with advances from the General Fund of the State of California, loans from financial institutions, and revenues from power sales to customers. The advances from the General Fund and the remaining balance of the loans from financial institutions were repaid from the proceeds of revenue bonds issued in October and November 2002.

Basis of Presentation

The Fund is accounted for as an enterprise fund and is financed and operated in a manner similar to that of a private business enterprise. The Fund uses the economic resources measurement focus and

Department of Water Resources Electric Power Fund
Notes to Financial Statements
For the nine months ended March 31, 2004 and 2003

the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. As allowed by governmental accounting standards, the Fund has elected not to apply statements and related interpretations issued by the Financial Accounting Standards Board after November 30, 1989. The Fund is accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenses.

Revenues and Recoverable Costs

Before the issuance of revenue bonds, the cost of energy provided by DWR and debt service was recovered through charges to the customers of the IOUs as authorized by AB1X and established by the CPUC. Revenues were recognized when energy provided by DWR was delivered to the customers. Prior to the issuance of the revenue bonds, costs were recovered through Power Charges. Since the issuance of the revenue bonds, customer charges are separated into two primary components, Power Charges and Bond Charges. Power Charge revenues recover the cost of power purchases, administrative costs and operating reserves and are recognized when energy provided by DWR is delivered to the customers. Certain customers of ESPs are assessed "cost responsibility surcharges" that are used by DWR for the same purposes as Power Charge revenues. Bond Charge revenues recover debt service and debt service reserves and are recognized when energy provided by either DWR or the IOU, or an ESP, is delivered to customers. Costs are recovered over a period of time as determined by DWR's revenue requirement process. Amounts that have been earned but not collected are recorded as the current portion of recoverable costs. Costs that are recoverable through future billings are recorded as long-term.

2. Restricted Cash and Investments

Restricted cash and investments, for purposes of the statements of cash flows, includes cash on hand and amounts in short-term investments. Amounts in short-term investments consist of deposits in the State of California Pooled Money Investment Account-Surplus Money Investment Fund (SMIF).

Cash not required for current use is invested in SMIF. SMIF has an equity interest in the State of California Pooled Money Investment Account (PMIA). The investments in PMIA are carried at fair value, which approximates amortized cost. Generally, the investments in PMIA are available for withdrawal on demand. Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and approximated 1.47% and 1.70% at March 31, 2004 and June 30, 2003, respectively.

3. Long-Term Debt

During October and November 2002, DWR issued \$11.264 billion in revenue bonds. The proceeds from the bond issue, along with the cash balance in the Fund at the date of issuance, were used to repay previously incurred debt (General Fund advances and a term loan from a financial consortium) and fund restricted cash and investment accounts as required by the Bond Indenture.

Department of Water Resources Electric Power Fund

Notes to Financial Statements

For the nine months ended March 31, 2004 and 2003

The following activity occurred in the long-term debt accounts during the Nine months ended March 31, 2004 (in millions):

	Revenue Bonds	Unamortized Premium	Total Revenue Bonds
Balance, June 30, 2003	\$ 11,264	\$ 372	\$ 11,636
Amortization of premium	-	(32)	(32)
Less current portion	<u>(180)</u>	<u>(42)</u>	<u>(222)</u>
Balance, March 31, 2004	<u>\$ 11,084</u>	<u>\$ 298</u>	<u>\$ 11,382</u>

The revenue bonds, all of which except Series E are tax-exempt, consist of the following at March 31, 2004:

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amounts Outstanding (in millions)
A	3.0-6.0%	2022	2012	\$ 6,314
B	Variable	2020	Callable	1,000
C	Variable	2022	Callable	2,750
D	Variable	2022	Callable	500
E	3.6-4.3%	2006	Not callable	<u>700</u>
				11,264
Plus unamortized premium				340
Less current maturities				<u>(222)</u>
				<u>\$ 11,382</u>

Series B and C have daily and weekly rate modes, respectively, and Series D have 35-day auction periods. The variable rate bonds have a final stated maturity of 2022, but will be retired in sinking fund installments from 2005 to 2022. Total interest expense and financing costs for the nine months ended March 31, 2004 and 2003 for all revenue bonds was \$327 million and 345 million, respectively. The interest rates for the variable debt for the three months ended March 31, 2004, ranged from 0.68% to 1.33%. The higher \$18 million in interest for the nine months ended March 31, 2003 related to financing prior to the bond issuance.

Principal and interest payments (and other bond related costs, including swap payments) are primarily secured by bond charges. The Fund is subject to certain bond covenants, including establishing funding and expenditure requirements for several restricted cash and investment accounts. The bonds

Department of Water Resources Electric Power Fund

Notes to Financial Statements

For the nine months ended March 31, 2004 and 2003

are limited special obligations of the Fund; neither the principal nor any interest thereon constitutes a debt of the State. Principal and interest for all Series B and certain Series C bonds (\$1.75 billion out of a total Series C size of \$2.75 billion) are to be paid from draws made under letters of credit. In the case of these bonds, draws made under the letters of credit are to be reimbursed on the same day by the Fund. There are no outstanding amounts on the letters of credit at March 31, 2004. The letters of credit expire in 2005. The Fund pays fees of 0.85% per annum on the stated amount of the letters of credit.

The remaining \$1 billion of Series C bonds is credit enhanced by bond insurance. Liquidity support for these bonds is provided by bank liquidity facilities. Any amounts paid under the bond insurance facilities are immediately due and payable by the Fund. Bonds purchased under the initial liquidity facilities are required to be redeemed in equal installments over a five or seven year period. There are no outstanding amounts on liquidity facilities at March 31, 2004. Three liquidity facilities backing \$300 million in Series C bonds expire in 2005, and two liquidity facilities underlying \$700 million of Series C bonds expire in 2009. The Fund pays fees of between 0.22% and 0.37% per annum on the available amounts under the liquidity facilities.

Future payment requirements on the revenue bonds are as follows at March 31, 2004 (dollars in millions):

Fiscal Year	Principal	Interest¹	Total
2004	\$ 180	\$ 191	\$ 371
2005	388	397	785
2006	409	380	789
2007	427	362	789
2008	449	343	792
2009-2013	2,612	1,406	4,018
2014-2018	3,397	785	4,182
2019-2022	3,402	184	3,586
	<u>\$ 11,264</u>	<u>\$ 4,048</u>	<u>\$ 15,312</u>

¹ Variable portion of the interest cost calculated using the March 31, 2004 Bond Market Association Municipal Swap Index (BMA)

4. Interest Rate Swaps

DWR, on behalf of the Fund, entered into interest rate swap agreements with various counterparties, to reduce variable interest rate risk. The swaps create a synthetic fixed rate for DWR. DWR has agreed to make fixed rate payments and receive floating rate payments on notional amounts equal to a portion of the principal amount of DWR's variable rate debt.

Department of Water Resources Electric Power Fund

Notes to Financial Statements

For the nine months ended March 31, 2004 and 2003

The terms, fair values, and credit ratings of counterparties for the various swap agreements are summarized in the following table (dollars in millions):

Outstanding Notional Amount at March 31, 2004	Fixed Rate Paid by Fund	Variable Rate Received by the Fund ¹	Fair Values at March 31, 2004	Swap Termination Date	Counterparty Credit Ratings (Moody's, Fitch's, S&P)
\$ 94	2.914%	67% of LIBOR ²	\$ (5)	5/1/2011	Aa, AAA, AAA
234	3.024%	67% of LIBOR	(11)	5/1/2012	Aa, AAA, AAA
200	3.405%	BMA ³	(9)	5/1/2013	Aa3, AA-, AA-
100	3.405%	BMA	(4)	5/1/2013	Aa3, AA-, A+
30	3.405%	BMA	(1)	5/1/2013	Aa3, AA-, A+
194	3.204%	67% of LIBOR	(9)	5/1/2014	Aa1, AA, AA-
174	3.280%	67% of LIBOR	(10)	5/1/2015	Aa, AAA, AAA
202	3.342%	67% of LIBOR	(9)	5/1/2016	Aa3, AA-, A+
202	3.389%	67% of LIBOR	(9)	5/1/2017	Aa3, AA-, A+
\$ 1,430			\$ (67)		

¹ LIBOR based swaps converted to pay the Fund 67% of LIBOR on January 1, 2004

² One month U.S. Dollar London Interbank Offered Rate

³ Bond Market Association Municipal Swap Index

The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions to outstanding notional amounts that follow scheduled amortization of the associated debt.

Fair Value: Because interest rates have declined, all swaps had a negative fair value as of March 31, 2004. The reported fair values from the table above were provided by the counterparties, using the par value, or marked-to-market, method.

Credit Risk: As of March 31, 2004, the Fund was not exposed to credit risk because the swaps had negative fair values. However, should interest rates increase and the fair values become positive, the Fund would be exposed to credit risk in the amount of the swaps' fair value. DWR has a total of nine swap agreements with six different counterparties. Three swaps, approximating 35 percent of the total notional value are with a single counterparty with a credit rating of Aa/AAA/AAA. Of the remaining swaps, two are held with a single counterparty, approximating 21 percent of the outstanding notional value. That counterparty has credit ratings of Aa3/AA-/A+. The remaining four swaps are with separate counterparties, all having Aa3/AA-/A+ ratings or better.

Basis Risk: The Fund is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR (a taxable rate index). The basis risk results from the fact that DWR's floating interest payments payable on the underlying debt are determined in the tax-exempt market, while DWR's floating receipts on the swaps are based on LIBOR, which is determined in the

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taxable market. Should the relationship between LIBOR and the tax-exempt market change and move to convergence, or should DWR's bonds trade at levels worse (higher in rate) in relation to the tax-exempt market, DWR's all-in costs would increase. As of March 31, 2004, the variable rate on DWR's bonds ranged from .68% to 1.33%, while the Fund received 67% of LIBOR on the swaps.

Termination Risk: DWR's swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk. In keeping with market standards, DWR or the counterparty may terminate a swap agreement if the other party fails to perform under the terms of the contract. In addition, the swap documents allow either party to terminate in the event of a significant loss of creditworthiness by the other party. DWR views such events to be remote at this time. If a termination were to occur, at the time of the termination, DWR would be liable for payment equal to the swap's fair value, if it had a negative fair value at that time. The counterparty would be liable for any payment equal to the swap's fair value, if it had positive fair value at that time. In addition, a termination would mean that DWR's underlying floating rate bonds would no longer be hedged, and DWR would be exposed to floating rate risk, unless it entered into a new hedge following termination.

Rollover Risk: Since the swap agreements have termination dates and notional amounts that are tied to equivalent maturity dates and principal amounts of amortizing debt, there is no rollover risk associated with the swap agreements, other than in the event of a termination.

Swap Payments and Associated Debt: As rates vary, variable-rate bond interest payments and net swap interest payments will vary. As of March 31, 2004, debt service requirements of the hedged variable-rate debt and net swap payments, assuming current interest rates remain the same, for their term were as follows (in millions):

Fiscal Year Ending June 30	Variable Rate Bonds		Interest Rate Swaps, Net	Total
	Principal	Interest		
2004	\$ -	\$ 4	\$ 9	\$ 13
2005	-	15	35	50
2006	-	15	35	50
2007	-	15	35	50
2008	-	15	35	50
2009-2013	658	69	166	893
2014-2017	772	20	51	843
Total	\$ 1,430	\$ 153	\$ 366	\$ 1,949

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5. Commitments and Contingencies

Litigation and Uncertainties

DWR remains involved in several lawsuits and regulatory proceedings, but has reduced some of its exposure to its previously reported litigation and uncertainties.

In one matter, two energy suppliers have petitioned the Federal Energy Regulatory Commission ("FERC"), contending that amounts totaling \$58 million are owed by DWR for power it purchased in the last half of January 2001 in the California Independent System Operator (ISO) market. The ISO distributed the Fund's January payment on a pro-rata basis to all market participants for the entire month, leaving energy suppliers with less than full payment for the amounts owed them for power purchased by DWR from January 17-31. On November 25, 2002, FERC issued an order finding that the ISO had "misapplied the payment it received from CERS" and directed the ISO to reallocate and disburse DWR's January payment to those that supplied power for the period January 17 – 31, 2001." On December 22, 2003, FERC issued an order affirming its prior determination that ISO should split the disbursements for January 2001 into two separate periods because CERS' funding obligations did not commence until January 17, 2001.

In another action ("PG&E1"), PG&E contested the determination of DWR's revenue requirement submissions for calendar years 2001 and 2002. The trial court found that DWR had failed to follow the California Administrative Procedures Act (APA) and ordered DWR to do so. The trial court also ruled that its decision did not affect any prior actions taken by the CPUC, including the implementation of cost recovery of DWR's calendar years 2001 and 2002 revenue requirements. This ruling was appealed and was affirmed in part and reversed in part, on October 2, 2003, with the appellate court concluding that "AB1X does require DWR to make a determination that its revenue requirement is just and reasonable, but neither AB1X nor the APA requires a public hearing or compliance with the APA procedures." The deadline for appeal having passed and no appeal having been filed, the appellate court's decision is now final. The appellate court has submitted a remittitur to the trial court, but PG&E has taken no action to reactivate the case.

In October 2002, PG&E filed a lawsuit ("PG&E2") on the 2003 revenue requirements and the re-examined 2001-2002 revenue requirements, claiming that DWR had not adequately followed DWR's own regulations and claiming that a portion of DWR's revenue requirements were unjust and unreasonable and therefore invalid. On December 26, 2003, the Sacramento County Superior Court found that DWR failed to comply with its regulations and instructed DWR to reconsider its action by conducting further proceedings in accordance with its own regulations. The Court also stated that its ruling "does not nullify with, or in any way affect any action that has been taken by the California Public Utilities Commission, including the enforcement and collection of existing rates and charges, to implement DWR's revenue requirements." DWR plans on complying with the Court's order.

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There are a number of other lawsuits and regulatory proceedings in which DWR is not a party but may be affected by the result. In one case, California Power Exchange Corporation (CalPX), certain IOUs and others have brought suit against the State of California claiming that the State's commandeering of CalPX's block forward contracts after CalPX filed bankruptcy in early 2001 was unconstitutional. The plaintiffs argue that they are entitled to damages of \$1.1 billion, which is their estimation of the fair value of the block forward contracts at the time of commandeering. Under the block forward contracts, which expired in December 2001, the Fund paid approximately \$350 million for energy provided by the contracts. This case is still ongoing. Additionally, various actions are underway contesting certain long-term power contracts entered into by DWR.

These lawsuits and regulatory proceedings could impact power costs and the related revenue requirements, and the terms and conditions of the power purchase contracts.

Management believes that the existing lawsuits and regulatory proceedings will be resolved in calendar year 2004. Because of the early stage of the legal and regulatory proceedings, the ultimate outcome of these matters cannot be presently determined.

Commitments

DWR has entered into power purchase contracts, some of which have remaining lives through 2014. Power purchases made under these contracts approximated \$1.2 billion and \$1.0 billion for the three months ended March 31, 2004 and 2003, respectively, and \$4.0 billion and \$3.5 billion for the nine months ended March 31, 2004 and 2003, respectively.

The remaining amounts of fixed obligations under the contracts as of March 31, 2004, are as follows:

For the Year Ending June 30,	Fixed Obligation (in millions)
2004	753
2005	3,190
2006	2,809
2007	2,525
2008	2,378
Thereafter	5,681
	<u>\$ 17,336</u>

In addition to the fixed costs there are variable costs with several of the contracts. The difference between the fixed costs and the expected total costs of the contracts are primarily due to the variable factors associated with dispatchable contracts and the cost of natural gas.

Contingencies

The Fund is self-insured for most risks, including general liability and workers' compensation. Management believes that any costs associated with such losses are recoverable from customers as part of DWR's revenue requirement.

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6. Bill Credit

Based on the net impact of 1) the ability to reduce reserves as allowed under the Bond Indenture, 2) the expected receipt of cash for past due amounts being held in trust by PG&E, and 3) increases in actual and forecasted costs, in July 2003 DWR decreased its 2003 revenue requirement by \$1.002 billion. On September 4, 2003, the PUC ordered implementation of the decrease in revenue requirements through credits for DWR Power Charges in the monthly billings to IOU customers from mid September through mid October 2003. Amounts expected to be received from PG&E, net of PG&E customers' portion of the bill credit, were received on September 11, 2003. Processing of substantially all of the bill credit was finalized during the three months ended December 31, 2003.